IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

Ruben Garcia, derivatively for the benefit of and on behalf of the Nominal Defendant Popular, Inc., **Plaintiff(s)** v. Richard L. Carrión, et. al. **Defendant(s)**	**CIVIL NO.** 09-1507 (JAG)

OPINION AND ORDER

GARCIA-GREGORY, D. J.

Pending before the Court are two Motions to Dismiss. One is on behalf of the individual members of the Board of Directors of Popular, Inc., Richard L. Carrión ("Carrión"), Juan J. Bermúdez ("Bermúdez"), Maria L. Ferré ("Ferré"), Michael J. Masin ("Masin"), Manuel Morales ("Morales"), Francisco M. Rexach ("Rexach"), Frederic V. Salerno ("Salerno"), William J. Teuber ("Teuber"), and Jose R. Vizcarrondo ("Vizcarrondo"), (Collectively "the Directors"), as well as three executive officers of the company, David H. Chafey ("Chafey"), Roberto R. Herencia ("Herencia"), Jorge A. Junquera ("Junquera"), (Collectively "the Officers"), and Popular, Inc. ("Popular"). (Dockets No. 47, 62)[1]. This group will be referred to as "Defendants." For the reasons discussed below,

[1]The Motion to Dismiss in Docket 62 is the same as that on Docket 47.

the Court **GRANTS** in part and **DENIES** in part Defendants' Motion to Dismiss.

The second pending Motion to Dismiss was filed on behalf of Pricewaterhouse Coopers, LLP, also a Defendant in the suit, hereafter "PwC." (Docket No. 88). For the reasons discussed below, the Court **GRANTS** PwC's Motion to Dismiss.

FACTUAL AND PROCEDURAL HISTORY[2]

Popular is a Puerto Rico Corporation and a publicly owned bank holding company which operates and controls subsidiaries in, among other places, Puerto Rico ("Popular PR") and the mainland United States ("Popular US"). Popular is named as a Nominal Defendant. Popular US has offered retail and commercial banking services through Banco Popular North America ("BPNA") and consumer finance services through Popular Financial Holdings ("PFH"). BPNA operates the subsidiary E-LOAN, which provides online lending.

Carrión has been Chairman of the Board of Popular since 1993, and has held positions as President or CEO of various divisions and subsidiaries of Popular since then.

Bermúdez, Rexach, Teuber, and Salerno are Board directors who serve on the Audit Committee, with Teuber[3] serving as the chairperson. Teuber and Salerno are designated as "financial experts" pursuant to Item 407(d)(5) of Regulation S-K under the Securities Exchange Act of 1934, which requires, among other things, that they either understand Generally Accepted Accounting Principles ("GAAP") and have experience analyzing financial statements of the same level of complexity that they will be faced with at their current post, or experience supervising someone who with such experience. The Audit Committee was charged with overseeing outside auditors and the preparation of financial statements and was provided with full access to Popular's books and records. This committee discussed 10-K and 10-Q forms at 26 of the 35 total meetings it held during 2007, 2008, and 2009.

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[2]The following statements, unless otherwise noted, derive from Docket No. 66.

[3]Garcia states that Salerno was the chairperson of the Audit Committee, (Docket. No. 66 ¶ 38), but later states that it was Teuber, (Docket No. 66 ¶ 60). At this juncture, nothing in the case turns on this discrepancy.

Bermúdez, Ferré, Morales, Rexach, and Teuber are all Board directors who serve on the Compensation Committee, with Rexach being the chairperson. This committee met five times during the relevant years, and is responsible for reviewing incentives and compensation arrangements to ensure that officers are not encouraged to take unnecessary and excessive risks that may threaten Popular's financial health.

PwC served as Popular's outside auditor at all relevant times, providing auditing and tax services as well as preparing financial statements at issue in this case, which the Directors are then alleged to have approved.

The Plaintiff, Ruben Garcia ("Garcia"), is and has been a shareholder of Popular at all relevant times, and pleads in his Complaint that this is not a collusive action designed to confer jurisdiction that the Court would not otherwise have.

For the years ending December 31, 2006 through 2008, Popular's recorded gross deferred tax assets grew from $437 million to over $1.3 billion, and the company did not record any "meaningful" valuation allowances against this asset with the Securities Exchange Commission ("SEC") until the third quarter of 2008. The SEC has a process for establishing the official, legally appropriate way to account for deferred tax assets, and it is Popular's and PwC's compliance with those accounting standards which are an issue in this case.

On June 5, 2009, Garcia filed a Complaint with the Court, which was most recently amended January 8, 2010. The Complaint, setting forth a shareholder derivative action, alleges that (1) the Defendants violated their fiduciary duties of loyalty and care in managing the financial affairs of Popular, including (a) having failed to inform themselves of PwC's wrongful accounting and failing to record a valuation allowance for deferred tax assets, and (b) publicly offering $400 million in stock pursuant to a false and misleading registration statement, (2) the Defendants grossly mismanaged Popular in violation of their duties to shareholders, (3) the Defendants wasted corporate assets by virtue of leaving the company open to lawsuits, which would consume millions of dollars in lawyer's fees and adverse judgments or settlements, by offering excessive compensation, and by squandering the company's goodwill, and (4) because PwC accepted approximately $16 million in fees for financial accounting that violated federal law, they were unjustly enriched at Popular's expense and should reimburse the company for fees collected. The Complaint further alleges that Garcia is excused from making a demand that the corporation bring this suit on its own behalf.

DISCUSSION

I. DEMAND FUTILITY STANDARD

Review of a shareholder derivative suit brought under federal law proceeds under the heightened pleading standard of Fed. R. Civ. P. 23.1, which requires that the plaintiff shareholder plead in his complaint facts "with particularity" which establish either a failed demand that the corporation bring the suit, or that such demand would be futile. Fed. R. Civ. P. 23.1. This Rule, however, establishes only the elements required to be pled, and does not relate to a substantive right or obligation. Kamen v. Kemper Financial Servs., 500 U.S. 90, 96 (1991); Gonzalez Turul v. Rogatol Distrib., 951 F.2d 1, 2 (1st Cir. 1991). While the SEC regulations alleged to be violated in the present case are federal in nature, the courts look to state law rather than to federal common law to determine the nature of the rights in question when, as here, "private parties have entered legal relationships with the expectation that their rights and obligations would be governed by state-law standards," Kamen, 500 U.S. at 98 (citing United States v. Kimbell Foods, Inc., 440 U.S. 715, 728 (1979)).

Popular is a Puerto Rico Corporation, thus the Court relies on Puerto Rico law to determine the contours of the demand requirement, and the exception for demand futility. Because Puerto Rico law does not outline the standard for demand futility, the Court looks to Delaware corporate law, after which Puerto Rico corporate law was modeled. In re First Bancorp Derivative Litig., 465 F. Supp. 2d 112, 118 (D.P.R. 2006).

Garcia does not claim to have made a demand upon the corporation. Instead, he alleges that such demand would have been futile, and is thus excused. The First Circuit enforces the demand requirement vigorously. Heit v. Baird, 567 F.2d 1157, 1160 (1st Cir. 1977). Relaxing the demand requirement would eviscerate the value of the business judgment rule, a "powerful presumption," Rales v. Blasband, 634 A.2d 927, 933 (Del. 1993), though rebuttable, that directors have acted in the company's best interests and in good faith, placing the burden on a challenging plaintiff to prove otherwise. Aronson v. Lewis, 473 A.2d 805, 812, 815 (Del. 1984), overruled on other grounds by Brehm v. Eisner, 746 A.2d 244 (Del. Supr. 2000).

Delaware law establishes two separate tests for excusal from the demand requirement which effectively rebut the business judgment rule. The two-prong Aronson test excuses demand if a "reasonable doubt" arises from the particularized facts alleged that: "(1) the directors are disinterested and independent [or][4] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." Aronson, 473 A.2d at 814; Wiley v. Stipes, 595 F. Supp. 2d 179, 185 (D.P.R. 2009). The Rales test, on the other hand, inquires as to "whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." Rales, 634 A.2d at 934. The Aronson test is applicable when directors themselves have acted or have consciously failed to act, Aronson, 473 A.2d at 813, whereas the Rales test is applicable in circumstances when the director-defendants are not themselves responsible for the conscious act or failure in question,[5] Rales,

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[4]"The Aronson test is a disjunctive one. If the plaintiff satisfies either prong demand is excused." MCG Capital Corp. v. Maginn, 2010 WL 1782271, *16 (Del. Ch. 2010), citing Brehm v. Eisner, 746 A.2d at 256.

[5]"This situation would arise in three principal scenarios: (1) where a business decision was made by the board of a company, but a majority of the directors making the decision have been replaced; (2) where the subject of the derivative suit is not a business decision of the board; and (3) where . . . the decision being challenged was made by the board of a different corporation." Rales, 634 A.2d at 934.

634 A.2d at 933-43.

II. DEMAND FUTILITY AS TO THE DIRECTORS AND OFFICERS UNDER ARONSON

Garcia asserts numerous times that the Directors and Officers "knew or should have known" that their financial reports, including the proxy statement that underlay the Series B Offering, were false and materially misleading, and that they were required by their fiduciary duties to ensure that the company was run in accordance with sound business judgment, which they "conscious[ly]" failed to do. (Docket No. 66). He claims that these Defendants were "responsible for the misconduct alleged," and that demanding them to sue the wrongdoers on behalf of the corporation would require the board members to sue themselves. Id. As the allegations of the Complaint relate to an action or decision of the board, they are cast squarely within the framework of Aronson and will be analyzed thereunder.

A. ARONSON'S FIRST PRONG: DISINTERESTED & INDEPENDENT

First, a director is "interested" when she or he stands to gain personally from a corporate activity or abstention which does not likewise benefit the shareholders, or when she or he will absorb a negative impact which the corporation or its shareholders would not similarly suffer. Rales, 634 A.2d at 936; In re First Bancorp Derivative Litig., 465 F. Supp. 2d at 118-19. "In such circumstances, a director cannot be expected to exercise his or her independent business judgment without being influenced by the adverse personal consequences resulting from the decision." Rales 634 A.2d at 936.

Regarding potential adverse personal consequences, "the mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors." Aronson, 473 A.2d at 815. Similarly insufficient is "an allegation that a majority of directors approved, participated, or acquiesced" in the action in question. Grobow v. Perot, 526 A.2d 914, 924 (Del. Ch. 1987), overruled on other grounds by Brehm, 746 A.2d 244. However, under Aronson, if an action is sufficiently egregious it may fail as a legitimate business judgment, and thus give rise to a "substantial likelihood of director liability." Aronson, 473 A.2d at 815.

Secondly, a director is "dependent" when facts are alleged with particularity that the director is "beholden" to another person on account of their personal or other relationships. Aronson, 473 A.2d at 815. Such familial, social, financial, or other relationships are compromising only if they suggest that the corporate actor would rather compromise his or her professional reputation than to risk harm to that relationship. In re Sonus Networks, Inc., S'holder Derivative Litig., 499 F.3d 47, 67-68 (1st Cir. 2007) (citing Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1052 (Del. 2004)).

Garcia alleges that each director was interested or dependent, relying on family relationships within the company, co-membership on boards of other companies, and being dominated by or beholden to Carrión. He also references Defendants' status as defendants in other lawsuits as a factor which renders the Defendants sufficiently interested. Under the first prong of the Aronson test, the threat of personal liability must rise to one of "substantial likelihood" to create a "reasonable doubt" that the directors are disinterested. Aronson, 473 A.2d at 815. The predicate for such a liability-attaching lawsuit could well be a breach of fiduciary duties. The present Motion, however, is more aptly considered under the second prong, which inquires into the directors' conformance with such fiduciary duties, regardless of what personal liability such a breach might create. For a Motion to Dismiss to survive the second prong, a "reasonable doubt" that the directors fulfilled these duties will cast sufficient doubt that the decision was a valid exercise of business judgment, and permit the complaint to move beyond this juncture. Id.

B. ARONSON'S SECOND PRONG: VALID EXERCISE OF BUSINESS JUDGMENT

The shareholders of a corporation are entitled to rely on the board of directors to fulfill their fiduciary duties at all times. Emerald Partners v. Berlin, 787 A.2d 85, 90 (Del. Super. Ct. 2001). Failure to adequately discharge those duties in the course of a corporate action strips the directors of the presumption that that action was a valid exercise of business judgment. Id. To deny a Motion to Dismiss in a shareholder derivative context, the court "must be satisfied that a plaintiff has alleged facts with particularity which, taken as true, support a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment." Aronson, 473 A.2d at 815. "Only in that context," under the second prong of Aronson, "is demand excused." Id. Thus, if a reasonable doubt arises that an action was taken in compliance with the directors' fiduciary duties, demand is excused under this prong. See Beam, 845 A.2d at 1048-49.

Two fiduciary duties inhere to a corporate board of directors: the duty of loyalty and the duty of care.[6] "One cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey." Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003). This duty of "legal fidelity" is built in as a "subsidiary element of the fundamental duty of loyalty." Id. See Metro Commc'n Corp. BVI v. Advanced Mobilecomm Techs., Inc., 854 A.2d 121, 131 (Del. Ch. 2004).

In this case, the activity alleged to be illegal was Popular's failure to record a valuation allowance for deferred tax assets, in violation of federal SEC regulations, GAAP, and Statement of Financial Accounting Standard ("SFAS") 109.[7] Deferred tax assets are operating losses, tax credits and future tax deductions that can be used to offset taxable income in future years, if that taxable income materializes. (Docket No. 66).

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[6]The Delaware Supreme Court has equated "good faith" with "loyalty," and "care" with "due diligence," acknowledging two distinct fiduciary duties while expressing synonyms by which they may also be represented. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 368 n.36 (Del. 1993); See Guttman v. Huang, 823 A.2d 492, 506 (Del. Ch. 2003); In re Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 475 (Del. Ch. 2000).

According to Garcia, SFAS 109 requires a company to claim a valuation allowance if it is "more likely than not" that the deferred tax assets will not reduce the company's future taxable income. Id. To fail to claim a valuation allowance in such a situation is illegal, Garcia contends, because it artificially inflates a company's worth. In this case, the further contention is that Popular would have been restricted by the FDIC from engaging in certain business operations if they had recorded the valuation allowance, because the valuation allowance would have shown Popular to be undercapitalized. Popular instead mendaciously purported to be "well-capitalized" by neglecting to record a valuation allowance and thus was able to avoid FDIC restrictions. Id.

[7]The Financial Accounting Standards Board, the organization responsible for formulating official standards for financial accounting as recognized by the SEC, set forth SFAS 109, which establishes GAAP for deferred tax assets. (Docket No. 66). Garcia points to SEC Regulation S-X (17 C.F.R. § 210.4-01(a)(1)) to establish that financial statements filed with SEC by publicly traded companies, such as Popular, must be filed in accordance with GAAP. (Docket No. 66).

Meanwhile, Garcia points out that Puerto Rico is an independent taxation authority, by mutual agreement with the U.S. Congress, and as such, Popular's 2007 SEC Form 10-K states that "[t]he Corporation's U.S. subsidiaries . . . are considered foreign under Puerto Rico income tax law . . . ." For this reason, any deferred tax assets accumulated under Popular US can only be realized by future profits earned by Popular US, and cannot be transferred to Popular PR. Id.

Garcia asserts that a series of "red flags" should have alerted the Defendants that Popular was not "more likely than not" able to realize enough future earnings to derive a benefit from the full value of the deferred tax assets. Under the second prong of the Aronson test, the issue of demand excusal is going to turn on whether these "red flags" create a "reasonable doubt" that the decision not to record a valuation allowance was done legally. If that decision was contrary to law, it was also contrary to the duty of loyalty, which renders the decision an invalid exercise of business judgment.

Starting in 2005, Popular US steadily lost income, earning $171 million in 2005, $10 million in 2006, and losing $645 million in 2007. Id. According to SFAS, a "cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome." Id. Beginning in 2006, Popular's number of non-performing loans increased and the company had to increase its loan loss reserve as the housing market faltered. Id. Then, in 2007, Popular US began to sell off portions of its operations, including PFH and E-LOAN. Id. Garcia contends that the information that the Defendants had available to them regarding a diminished operational capacity, mounting debt, and adverse market forces, made it clear that Popular did not stand to realize value from the entirety of its deferred tax asset. That asset, continuing to grow in relation to further financial losses, grew to $808 million by the time Sterne Agee & Leach, Inc., a sercurities analyst firm, took notice. Id. The firm issued a report on July 22, 2008 noting that Popular US's deferred tax asset accounted for twenty-seven percent of the firm's equity, and positing that while Popular would probably be able to utilize some of the asset, the analyst firm "continue[s] to question the viability of the [Popular US] portion of this asset." Id.

On October 22, 2008, Popular US recorded a partial valuation allowance, and on January 22, 2009 recorded a valuation allowance against the full value of the deferred tax assets, at that time $861 million. Id. Junquera, on a March 2009 conference call, stated that, "we had to confront reality toward the end of last year." Id.

This came only after a May 22, 2008 Series B Offering, raising the company more than $386 million in profits from sale of stock. Id. Garcia contends that the company purposefully waited to record a valuation allowance until after selling the stock, because recording the valuation allowance would reduce the value or saleability of the stock. Indeed, Garcia points to common stock prices dropping by fifty percent upon news of the full valuation allowance, with Popular US then losing over fifty percent of its market capitalization. Id.

Meanwhile, SFAS 109 requires a company to evaluate both "positive evidence" and "negative evidence" when determining the necessity of recording a valuation allowance, with the caveat that "[t]he more negative evidence that exists (a) the more positive evidence is necessary and (b) the more difficult it is to support a conclusion that a valuation allowance is not needed for some portion or all of the deferred tax asset." Id. In addition, "[f]orming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years." Id.

Because this information, in combination, provides a "reason to doubt"[8] the legality of declining to record a valuation allowance until 2009, demand is excused under the second prong of the Aronson test, where the presumption that the board took a valid business judgment can be rebutted by way of breach of fiduciary

[8] "Reasonable doubt can be said to mean that there is a reason to doubt." Grimes v. Donald, 673 A.2d 1207, 1217 (Del. 1996) (Footnote omitted) (overruled on other grounds by Brehm, 746 A.2d 244).

duties, which includes "legal fidelity."

III. BREACH OF FIDUCIARY DUTIES

Garcia contends that claims of breach of fiduciary duty are subject to review under Rule 8(a) when they do not allege fraud as an essential element. This is correct,[9] but only where the claim itself neither explicitly alleges fraud, nor sounds in fraud.[10] The pleading standard for allegations of fraud requires the plaintiff "to state with particularity the circumstances constituting fraud or mistake," although the mental state of the offending party may be alleged generally. Fed. R. Civ. P. 9(b). Here, there is no explicit fraud claim, but the claim itself sounds in fraud. The contention is that the Defendants knew or should have known that the valuation allowance needed to be recorded, that they failed to do so consciously and in violation of federal securities laws, that this was done with the effect of evading FDIC restrictions and enabling the company to sell over $386 million in stock, which severely diminished in value when the valuation allowance was subsequently properly recorded. This type of willful misleading is the stuff that fraud claims are made of.[11]

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[9]"Although there is a dearth of case law, the Rule 9(b) heightened pleading requirement generally does not apply to the state law claims of breach of fiduciary duty, negligent misrepresentation, gross negligence, mismanagement, unjust enrichment, aiding and abetting breach of fiduciary duty, and breach of contract." In re Fruehauf Trailer Corp., 250 B.R. 168, 197-98 (D. Del. 2000) (footnotes omitted).

[10]"Where an allegation of fraud lies at the core of a cause of action, the heightened pleading standards of [Rule] 9(b) apply." Gwyn v. Loon Mountain Corp., 2002 WL 1012929, *7 (D.N.H. 2002), aff'd, 350 F.3d 212 (1st Cir. 2003). See also Rahl v. Bande, 328 B.R. 387, 412 (S.D.N.Y. 2005) (comparing claims premised on fraud, such as breaches of fiduciary duty which make use of misrepresentations or omissions to induce action, with claims that are not premised on fraud, such as a breach of fiduciary duty that results in harm to the company without inducing action).

Garcia's Complaint certainly contains sufficient particularity to survive a Motion to Dismiss against this heightened standard. Rule 9(b) requires the "circumstances constituting fraud" to be plead with particularity, which includes the time, place, and content of the alleged misrepresentation. Wayne Inv., Inc. v. Gulf Oil Corp., 739 F.2d 11, 13 (1st Cir. 1984). Garcia's complaint tracks Popular's financial statements, the timing of the company's financial losses, Popular's minimizing and selling off of subsidiaries, and references to content of the documents that were filed in conjunction with the Series B stock offering. As for the mental state that establishes fraud, one need only allege knowledge, intent, and other mental conditions generally. Fed. R. Civ. P. 9(b). However, "[t]he courts have uniformly held inadequate a complaint's general averment of the defendant's knowledge of material falsity, unless the complaint also sets forth

[11] Fraud is defined as a "knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment." Black's Law Dictionary 731 (9th ed. 2009)

specific facts that make it reasonable to believe that defendant knew that a statement was materially false or misleading." Greenstone v. Cambex Corp., 975 F.2d 22, 25 (1st Cir. 1992) (citations omitted) superseded by statute on other grounds, Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737, as recognized in N. Am. Catholic Educ. Programming Found., Inc. v. Cardinale, 567 F.3d 8, (1st Cir. 2009). Here, the Complaint alleges "actual or constructive knowledge" and establishes a series of "red flag" events and indicators that would have allegedly conferred such knowledge, (Docket. No. 66), an allegation which is reasonable enough to survive the present Motion to Dismiss.

IV. GROSS MISMANAGEMENT

Garcia asserts a claim for gross mismanagement in addition to his claim for breach of fiduciary duties. However, alleging "gross mismanagement" here is nothing more than realleging his breach of fiduciary duty claim cloaked in phraseologically, but not legally, distinct language. A claim for gross mismanagement is treated as one for breach of fiduciary duty, In re Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 115 n.6, (Del. Ch. 2009), and because that claim has already been established here, it will not be entertained twice. Any authority on this issue which Garcia cites is off point, as not one case has allowed a plaintiff to maintain a breach of fiduciary claim concurrently with a claim for gross mismanagement. While Garcia may find allegations of mismanagement helpful as support for his breach of fiduciary claim, gross mismanagement is not cognizable as an simultaneous independent cause of action. By citing inapposite case law, Garcia has failed to establish any well-reasoned explanation for why the Court should depart from this Circuit's normal treatment of gross mismanagement.

The Court hereby **GRANTS** in part the Defendants' Motion to Dismiss as it pertains to this issue, **DISMISSING** Garcia's claim for gross mismanagement inasmuch as it is asserted as a separate actionable claim.

V. WASTE OF CORPORATE ASSETS

Garcia alleges that the Directors and Officers acted wastefully by (1) opening the corporation to legal fees and adverse judgments at a potential cost of millions of dollars (2) awarding excessive compensation, and (3) squandering Popular's goodwill in the process. Unlike Garcia's claim for breach of fiduciary duties, which is predicated on a theory of fraud and subject to review according to Rule 9(b), Garcia's claim for waste of corporate assets does not directly derive from allegations of fraudulent conduct, and so it is reviewable under Rule 8(a)'s pleading standard.

In Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007), the Supreme Court held that to survive a motion to dismiss under Rule

12(b)(6), a complaint must allege "a plausible entitlement to relief." Rodriguez-Ortiz v. Margo Caribe, Inc., 490 F.3d 92, 95-96 (1st Cir. 2007) (quoting Twombly, 550 U.S. at 599). The Court accepts all well-pleaded factual allegations as true, and draws all reasonable inferences in plaintiff's favor. See Correa-Martinez v. Arrillaga-Belendez, 903 F.2d 49, 51 (1st Cir. 1990). While Twombly does not require of plaintiffs a heightened fact pleading of specifics, it does require enough facts to have "nudged their claims across the line from conceivable to plausible." Twombly, 550 U.S. at 570. Accordingly, in order to avoid dismissal, the plaintiff must provide the grounds upon which his claim rests through factual allegations sufficient "to raise a right to relief above the speculative level." Id. at 555.

In Ashcroft v. Iqbal, 129 S.Ct. 1937 (2009), the Supreme Court upheld Twombly and clarified that two underlying principles must guide this Court's assessment of the adequacy of a plaintiff's pleadings when evaluating whether a complaint can survive a Rule 12(b)(6) motion. See Iqbal, 129 S.Ct. at 1949-50. The First Circuit has recently relied on these two principles as outlined by the Supreme Court. See Maldonado v. Fontanes, 568 F.3d 263, 266 (1st Cir. 2009). "First, the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions. Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." Iqbal, 129 S.Ct. at 1949 (citing Twombly, 550 U.S. at 555).

"Second, only a complaint that states a plausible claim for relief survives a motion to dismiss." Iqbal, 129 S.Ct. at 1950 (citing Twombly, 550 U.S. at 556). Thus, any nonconclusory factual allegations in the complaint, accepted as true, must be sufficient to give the claim facial plausibility. Iqbal 129 S.Ct. At 1950. Determining the existence of plausibility is a "context-specific task" which "requires the court to draw on its judicial experience and common sense." Id. "[W]here the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged - but it has not 'show[n]' - 'that the pleader is entitled to relief.'" Id. (quoting Fed. R. Civ. P. 8(a)(2)). Furthermore, such inferences must be at least as plausible as any "obvious alternative explanation." Id. at 1950-51 (citing Twombly, 550 U.S. at 567).

This standard of review must be applied in conjunction with the understanding that the test for corporate waste is a "stringent" one, requiring a showing that an exchange "is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." Brehm v. Eisner, 746 A.2d 244, 263 (Del. Supr. 2000) (citing In re Walt Disney Co. Derivative Litig., 731 A.2d 342, 362 (Del. Ch. 1998)). Furthermore, the Supreme Court has reached a similar formulation of the rule, holding an expenditure wasteful where the "payment has no relation to the value of services for which it is given, it is in reality a gift in part, and the majority stockholders have no power to give away corporate property[.]" Rogers v. Hill, 289 U.S. 582, 591 (1933) (internal citation omitted). Thus, a plaintiff must state facts that raise a plausible inference that the corporation's outflow of assets bore no adequate relationship to what value may have been obtained.

A. Wasteful Legal Costs

The first accusation of corporate waste relates to legal costs and liabilities springing from the wrongdoing elsewhere alleged. Garcia does not, however, allege what this cost will be beyond speculating that it will cost "millions of dollars," and nowhere avers that the corporation will not derive a legitimate value from defending its own actions, which heretofore have not been proven to violate the law. Garcia likewise does not contend that the corporation's legal counsel is charging a disproportionately high rate or is providing a largely worthless service. To the extent that case law on point would be elucidating, Garcia has cited none. Based on the paucity of facts alleged as to this issue, Garcia has not sufficiently pled that the possibility of legal defense constitutes millions of dollars in wasted corporate money.

B. Excessive Compensation

Garcia points to a thin slice of his Complaint as establishing that excessive compensation was paid, the basic thrust of which is that, through short-term incentive schemes, Carrión and the Directors (in particular) were encouraged to violate GAAP. This contention is most reasonably read only as support for his breach of fiduciary duty claim. The allegation that most clearly suggests an excessive compensation is Director Herencia's $3.2 million severance payment, with Garcia pleading nothing to suggest that such payment was out of line with general corporate practice or that it was unwarranted in relation to the value to Popular of the terms of severance under which Herencia agreed to leave the company. Despite Garcia's awareness of a "Resignation and Transition Agreement" between Popular and Herencia, Garcia does no more than to state conclusorily that the compensation offered was "unwarranted" and "excessive." (Docket No. 66). To arrive at this conclusion in the absence of supporting facts pled in the Complaint fails to live up to the mandate that a claim be plausible, rather than merely conceivable. Twombly, 550 U.S. at 570.

C. Goodwill

Garcia takes the opportunity in his Opposition to the Motion to Dismiss to alert the Court to a waste claim predicated on loss of goodwill nested within a single paragraph of his 107-page Amended Complaint. While the Complaint has other references to goodwill, those references discuss goodwill as a factor in assessing the overall value of the company, which in turn relates to the need to record a valuation allowance. Those references to goodwill do not present themselves in the context of a corporate waste claim. It is not clear that the paragraph Garcia now points to does any differently. Even if Garcia clearly articulated such a claim, he has failed to offer any legal support for using goodwill as the avenue to assert a corporate waste claim. While the Court could perhaps weave together its own original research and reasoning, the Court is not compelled to clothe so naked a claim in a suit of argumentation not of Garcia's own tailoring.

Having found that Garcia has failed to state a plausible claim for corporate waste, the Court hereby **GRANTS** in part the Defendants' Motion, **DISMISSING** Garcia's claim for waste of corporate assets.

VI. DEMAND FUTILITY AS TO PWC UNDER RALES

Garcia puts forth a claim of unjust enrichment against PwC for accepting $16 million for auditing services when the result was (allegedly) illegal financial statements submitted to the SEC in violation of federal law, which leaves its client Popular open to lawsuits. Because Garcia makes this claim as a shareholder of Popular, to enforce a right that Popular could have chosen to enforce for itself, he must either make demand on the board or else prove that the demand was futile. Fed. R. Civ. P. 23.1. The claims made against the other Defendants in this suit are reviewable under Aronson because the corporation's board took the actions in question. Aronson, 473 A.2d at 813. The claim against PwC, however, is not an action taken by Popular's board at all, and so is reviewed under Rales. Rales v. Blasband, 634 A.2d 927, 934 (Del. 1993).

The Rales test asks "whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." Rales, 634 A.2d at 930. In addition, Federal Rule of Civil Procedure 23.1 requires particularized fact pleading in the shareholder derivative context.

As PwC asserts in its Motion to Dismiss (Docket No. 96), Garcia has not pled any reason, let alone with particularity, why the Popular board of directors would fail to exercise its independent and disinterested business judgment in determining if and how to bring suit against PwC. Garcia's main contention here is that, because demand should be excused in regards to his derivative claim against Popular, his excuse should extend to his claim against the third-party auditing company PwC. Thus, he argues that his lack of making a demand on Popular to sue PwC, as well as his lack of pleading why making that demand would have been futile, should not prevent his claim against PwC from proceeding. The Court disagrees.

Analysis under the Rales test is different from analysis under the Aronson test in that only the latter excuses demand when there is a reason to doubt that the action in question was a valid business judgment. In assessing Garcia's claim against PwC, the proper inquiry under Rales requires the plaintiff to plead that the board of the corporation could not exercise uninterested and independent judgment regarding whether to sue the third party. It would be inconsistent with this Circuit's "vigorous" enforcement of the demand requirement, Heit v. Baird, 567 F.2d 1157, 1160 (1st Cir. 1977), to allow the requested excusal of demand in one context (when the action challenged is not of the board's own doing, which is reviewed under Rales) to ride on the coattails of an excusal in a different context (when the suit is against the board that made the decision, and excusal is based on a reasonable doubt that the board's actions were taken legally, which is reviewed under Aronson). The demand requirement is not a reasonless procedural formality. It ensures that under normal circumstances the directors will manage litigation in the best interests of the company, and prevents shareholders from asserting frivolous or strike suits. See McMullin v. Beran, 765 A.2d 910, 916-17 (Del. Super. 2000); Ryan v. Gifford, 918 A.2d 341, 352 (Del. Ch. 2007).

Garcia contends that had he made demand, the corporation would decline to sue PwC, but Garcia supports this only by saying that a suit against PwC would involve the board's own alleged simultaneous breach of fiduciary duties. While the issue of board liability may overlap with PwC's potential liability, it is well settled that exposure to liability is not enough to excuse demand. Aronson, 473 A.2d at 815. Garcia has not argued that suit against PwC would result in any personal "substantial liability" of the board that would be making that decision, and the assumption that the board would decline to bring suit is not sufficient, because there may be entirely valid reasons for such a decision.[12]

Therefore, the Court hereby **GRANTS** the Motion to Dismiss Garcia's claim against PwC.

CONCLUSION

For the foregoing reasons, the Court **GRANTS** in part and **DENIES** in part Defendants' Motion to Dismiss (Dockets No. 47, 62). The Court shall **DISMISS** Garcia's claims for gross mismanagement and for corporate waste, while Garcia's claim for breach of fiduciary duties remains pending. The Court **GRANTS** PwC's Motion to Dismiss (Docket No. 88).

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[12]"A board may in good faith refuse a shareholder demand to begin litigation even if there is substantial basis to conclude that the lawsuit would eventually be successful on the merits. It is within the bounds of business judgment to conclude that a lawsuit, even if legitimate, would be excessively costly to the corporation or harm its long-term strategic interests. It is not enough for a shareholder merely to plead facts sufficient to raise an inference that the board of directors would refuse a demand. A court should not intervene unless that shareholder raises the more troubling inference that the refusal itself would not be a good faith exercise of business judgment." In re INFOUSA, Inc. S'holders Litig., 953 A.2d 963, 986 (Del. Ch. 2007).

IT IS SO ORDERED.

In San Juan, Puerto Rico, this 11th day of August, 2010.

s/ Jay A. Garcia-Gregory
JAY A. GARCIA-GREGORY
United States District Judge